# Prepared Remarks of Secretary Shaun Donovan at the Progressive Policy Institute/American Action Forum's Keys to a Sustained Housing Recovery Forum

## National Press Club, Washington, DC

Tuesday, October 2, 2012

Thank you, Jason -- for that introduction. Let me also thank Will and everyone else for inviting me today.

For the remainder of today, you are going to discuss how to build on the improvements we've seen in our housing market -- the steps we need to take to bring private capital back and some of the decisions we face in building the next generation of housing finance.

These are some of the most consequential decisions we will make in the coming decade -- with broad implications not just for housing, but for wealth creation, our communities, and our economy.

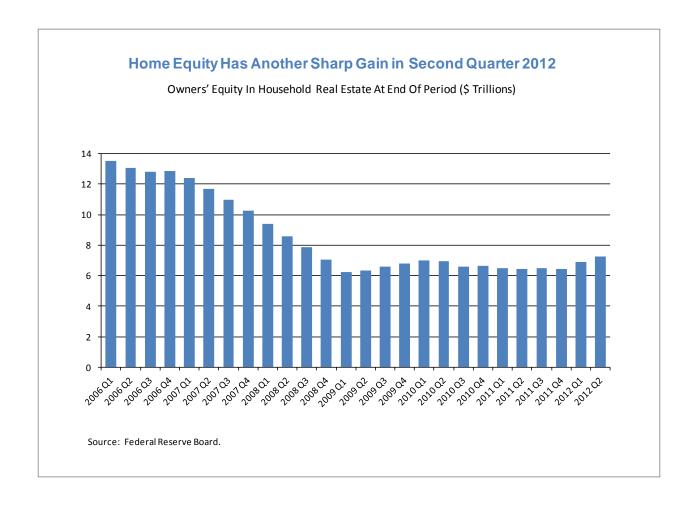
And so, with my remarks this morning, I wanted to provide some context for that discussion -- a survey of the Administration's response to the housing crisis that has brought us to this point.

As we speak, our housing market is showing important signs of recovery.

The number of families falling into foreclosure is half what it was in the early days of the Administration.

We had the strongest year of home sales since the crisis began, with housing construction growing faster than any time since 2008.

Home prices are on the rise, with the Case-Shiller home price index up year-over-year for the first time since September, 2010.



Combined with an increase in principal reductions, the Fed reports that \$860 billion in home equity was created in the first six months of 2012 -- and likely over a trillion dollars so far this year given the continued improvements we've seen since then.

Core Logic reports the growth in home equity helped lift 1.3 million families above water in the first half of this year.

There is of course much work to be done, and there are headwinds that could yet stall our early momentum. But it is important to take stock of where we are and how far we've come since 2009.

I want to describe the approach we took in the earliest months of the Administration.

I want to talk about the barriers we have faced -- the lessons we have learned and how our approach has evolved.

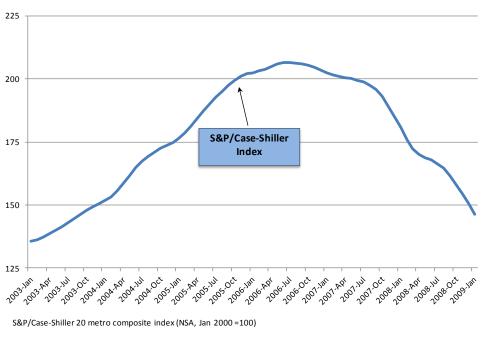
Finally, I want to share with you how the work we've done helps frame the fundamental tensions I see anchoring the debates we still need to resolve in order to bring our housing market to a more complete, lasting recovery.

#### **Changing the Trajectory**

First, I want to discuss the initial interventions we made to keep homeowners in their homes and our housing market afloat -- and to highlight what they accomplished in the President's first year in office in particular.

Obviously, this was a desperate time for our economy -- with more than 800,000 jobs lost just in the month President Obama was sworn in.

### House Prices Had Fallen 30 Consecutive Months By Jan 2009



Source: Standard and Poor's

Foreclosures, of course, were setting record levels.

After peaking in August of 2006, house prices were in freefall -- falling every month for 30 straight months. They would end up falling by nearly a third in that time -- and were expected to decline by another 17 percent by the time President Obama served his first year in the White House.

First, we focused on credit. Obviously, there has been a great deal of attention, particularly recently, on the Fed's actions to keep interest rates low.

But often missed in this discussion is the fact that low interest rates are only meaningful to housing if mortgage credit is available at those rates.

That's why the Administration's work to support Fannie Mae and Freddie Mac was critical -- because it sent a clear signal to the market that the GSEs would have support.

Our support for the Federal Housing Administration was particularly critical, playing a historic countercyclical role -- one it has only been called upon to fulfill a handful of times in its existence.

Few analysts have focused on this, but Mark Zandi has it exactly right: without FHA, "the housing market would have completely shut down" -- and it would've taken "the economy with it."

Second, we focused on demand. At a time when there was so much uncertainty in the market, the Recovery Act's extension and expansion of the First-Time Homebuyers Tax Credit gave potential buyers a sense of urgency when it came to purchasing a home.

Third, we provided help for distressed homeowners and neighborhoods.

The Home Affordable Modification Program, or HAMP, is often described as not living up to expectations -- but that was not the initial indication we had.

At a time when the wave of foreclosures seemed almost irreversible, HAMP--a completely new program and the largest modification effort in 75 years--reduced payments for a million people in its first 9 months.

Helping a million people who otherwise would have gone into foreclosure almost immediately wasn't all HAMP accomplished in its first year.

In those early months we also saw the program's other big impact: how the HAMP template changed the way proprietary modifications were done.

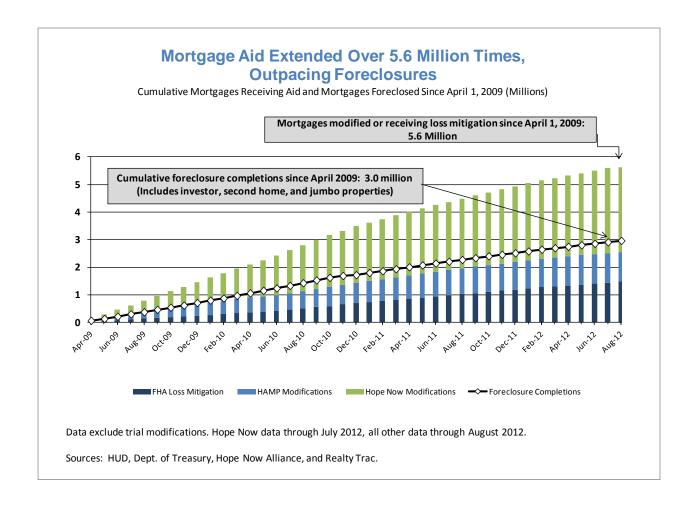
It's almost hard to believe today. But before HAMP, about half of proprietary mortgage modifications done by banks actually increased payments for borrowers.

Today, the OCC reports that 90 percent of all proprietary modifications reduce payments.

As a result, not only have HAMP modifications performed better than widely expected at that time, with only a 1-in-5 re-default rate -- but proprietary modifications have improved as well.

This increase and improvement in proprietary modifications also accounts for another misunderstood feature of HAMP.

Even though there has been a lot of focus on the number of families who either didn't qualify for HAMP or fell out of the HAMP program, in reality, only about 20 percent of families who didn't qualify for HAMP ended up in foreclosure. That is, in large part, because a significant share of families who didn't qualify for HAMP were ultimately able to qualify for a private modification that enabled them to keep their homes.



This is a big reason, as our latest housing scorecard shows, that while about 3 million families went through a foreclosure after HAMP was launched, nearly twice as many--5.6 million--have gotten the help they need to save their homes with average payment reductions of about \$380 per month according to the latest data from the OCC.

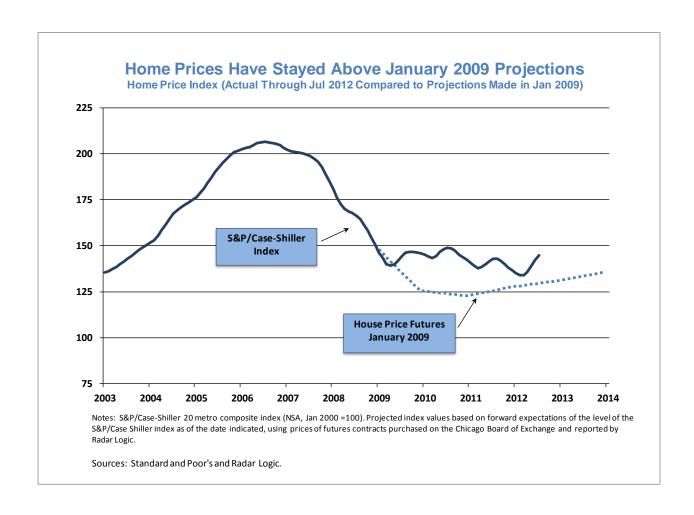
I would also note that help for homeowners wasn't the only relief we provided. We also provided the second of what would be three rounds of funding to distressed neighborhoods through the Neighborhood Stabilization Program, which is on track to address about 95,000 properties.

Compared to 3 million foreclosures, 95,000 may seem small. But it represents a quarter of the REO in the hardest-hit places -- and these tools now have a proven record of rebuilding not just neighborhoods, but home prices. In fact, data shows that three-quarters of places that received targeted investments through the first two rounds of NSP showed increased home prices relative to surrounding neighborhoods.

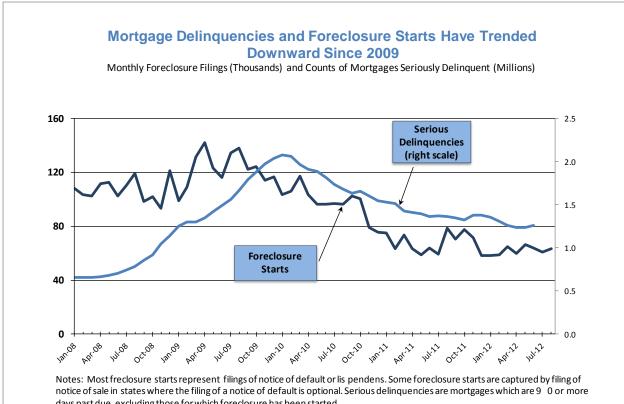
Indeed, it's been successful enough that the President believes we should build on this effort with a new Project Rebuild, part of the American Jobs Act, that would scale neighborhood stabilization up dramatically -- and create 200,000 jobs in these hard hit places.

## Reassessing as the Crisis Evolved

As we assessed all of these efforts during the President's first year in office, there was evidence that the work we had done in the housing market appeared to be having an impact.



Home prices in 2009 didn't decline by another 17 percent as forecasters were predicting. In fact, they started rising in the spring and were up for the next year.



days past due, excluding those for which foreclosure has been started.

Sources: Realty Trac and CoreLogic.

Foreclosure notices and delinquencies began what would be a long trend downward.

But as that year progressed, we increasingly understood that there were a number of barriers and challenges that would stand in the way of our housing efforts -- barriers that forced us to look at our efforts and reassess whether they could succeed.

The first barrier was one that had become increasingly clear during the campaign and transition:

#### Unemployment.

For housing, that meant the problem was shifting more and more from one of bad loans-subprime and predatory loans--to one of joblessness and underemployment.

The second barrier to recovery we were facing, as I alluded to earlier, was the capacity of HAMP servicers to implement it -- and the overdesign of the program itself.

This left increasing numbers of families dropping out of the program and fewer families qualifying after the initial surge of trial modifications.

The third barrier was complexity and conflicting incentives -- the dozens of different institutions who owned a single loan--not to mention subordinate debt or mortgage insurance--in our finance and securitization system without clear rules of the road you need when homeowners face a crisis.

The fourth barrier was negative equity. In the long run, we understood that we needed to reduce the number of people who owed more on their mortgage than their home was worth in order to fix what would be the longest lasting legacy of the crisis

Which brings me to the fifth and final barrier -- the simple fact that the Federal government had limited tools to change the behavior of lenders and servicers.

As evidence emerged that banks lacked capacity and were stymied by the complexity and conflicts of our finance system-- and that principal reduction was critical to providing families with a light at the end of the tunnel--we lacked the authority to establish those rules of the road independently -- and it would be difficult for Congress to act to establish them.

As a result of these barriers, which were often interrelated, what appeared to be the beginnings of a broader recovery in our economy and housing market stalled -- a fact that became especially clear with the expiration of the homebuyer tax credit in mid-2010.

So, in the next few minutes, I want to talk to you about how we went back and looked at our efforts, reassessed them and describe how they evolved in response to these barriers.

First, we adjusted our approach to deal with the increasing length and depth of unemployment.

As we were implementing the Recovery Act and the President's Auto Rescue, which saved more than a million jobs up and down the supply chain, we recognized that we needed a more robust strategy to help the unemployed stay in their homes.

At the time, 60 percent of the unemployed were out of work for more than three months -- and 45 percent were out of work for more than six months.

And while our initial HAMP design included a provision for unemployment forbearance that would help folks whose histories of employment and good credit before the crisis hit would likely resume once the worst of the storm had passed, we realized we needed to strengthen that provision.

That's why we extended the forbearance provided through FHA and HAMP to 12 months to bring it more into line with how long it took for folks to find a job. And within weeks of these actions, the industry began to follow suit, broadly adopting our standard and allowing families searching for work to catch up on payments.

To address the second barrier--the overdesign of HAMP and capacity of its servicers--we simplified the program, ramped up our oversight and made more people eligible.

Underappreciated in all this was that we also continued to ramp up investment in housing counselors -- proposing record high funding in the President's budgets.

HUD-approved housing counselors have helped more than 8 million families since President Obama took office. And with a recent HUD study showing that 7-in-10 at-risk homeowners who worked with a housing counselor got the help they needed to keep their home, it's clear housing counseling works.

That's one reason we urged states to use the payments they received from servicers as part of the National Mortgage Servicing Settlement to fund housing counseling efforts. And as of now, states have committed nearly a quarter billion dollars to housing counseling, making it one of the single largest counseling investment in history -- funded, I would note, not by the taxpayers but the institutions that have created such a demand for these kinds of services:

The banks.

Let me turn now to the third barrier I described: the complexity and conflicting incentives in our system.

Perhaps the best example of these challenges is in the HARP program, which intended to open up refinancing to underwater Fannie and Freddie borrowers.

As we implemented the program, we found a series of problems such as second lien holders and mortgage insurers that were blocking the refinancing of first mortgages even when a lower payment would seem to benefit the likelihood of their repayment.

As a result, at this time last year, HARP was responsible for less than a million refinances even as interest rates hovered below 4 percent.

That's why the President charged us to make big changes to HARP -- and by sitting down with lenders, mortgage insurers, regulators and investors to address these challenges one by one, we did.

Since that time, we've seen a 160 percent increase in total volume. More than 1 million families have applied and more than a half million refinances have closed -- saving these families on average \$3,000 per year.

The changes have been most dramatic for families who are deeply underwater. Where not a single conventional mortgage borrower with a loan-to-value ratio over 125 percent had been able to refinance before these changes went into place, in June and July alone, there were 81,000 refinances for these homeowners. That's a big reason the overall increases have been most eye-popping in hard hit states like Florida and Nevada -- by 175 and 260 percent respectively.

We also dramatically cut fees for FHA refinancing -- allowing families to pay minimum fees to refinance into a new FHA-insured loan. And in just the first three months, we saw a more than 200 percent increase in applications.

Even with refinancing at a 3-year high, as you know, we're now pushing for action on the President's proposal to allow every family current on their mortgage to refinance and rebuild what they've lost.

Another 8 million borrowers would be eligible to benefit under HARP with the Menendez-Boxer legislation, which would clear the remaining barriers to refinancing for homeowners with loans backed by Fannie and Freddie.

And another 3 million borrowers whose loans are not guaranteed by the government would be eligible under legislation proposed by Senator Feinstein.

Just as our work to support the GSEs in the earliest days of the Administration was essential to ensuring the Fed and Treasury's actions to keep interest rates low boosted our housing market and economy, getting the maximum impact of the Fed's recent QE3 action depends on passing President's refinancing proposal -- and allowing more than 10 million additional Americans the opportunity to refinance.

We've also begun to make progress addressing the fourth barrier to recovery, negative equity. As I mentioned, 1.3 million families were lifted above water in the first 6 months of the year.

Refinancing initiatives and low interest rates can help as well, if homeowners who refinance apply those savings to paying down principal more quickly. And families would have additional incentives to do that in Senator Merkley's Rebuilding Equity Act.

But refinancing alone won't help deeply underwater homeowners that are struggling to make their payments with no light at the end of the tunnel.

That's one reason why the historic \$25 billion settlement the Administration and 49 state attorneys general struck with the five largest servicers earlier this year was so important.

Early results indicate that roughly 165,000 families have received \$14 billion in relief so far.

What has made this relief significant is that banks are actually writing down on average more than \$105,000 in mortgage debt.

Now, some critics of the settlement have said that the amount of principal reduction we're going to see with the settlement is small compared to the problem.

But the settlement was never supposed to act alone.

Indeed, it builds on changes we made to HAMP at the same time we were finalizing the settlement earlier this year, which tripled incentives to investors.

As a result, more than three-quarters of non-GSE homeowners entering HAMP now receive a principal reduction averaging about \$70,000 per year.

Further, recent data from the OCC shows a 75 percent increase in loan modification trials outside of HAMP in the 2<sup>nd</sup> quarter of this year. As those trials become permanent, we expect 3<sup>rd</sup> quarter data to show a substantial increase in principal reduction.

Ultimately, our hope is that principal reduction becomes the standard approach for deeply underwater homeowners struggling to keep their homes.

The settlement was critical with respect to addressing the fifth and final barrier as well -- our inability to require servicers to act.

One of the most important revelations of the so-called "robo-signing" scandal was that many of the same institutions who got us into the crisis had not only not learned its lessons -- but were actually making it worse.

The settlement gave us a tool to require principal reduction at a time when Congress would not.

What has gotten less attention but in the long run will be equally as important is the comprehensive servicing standards it committed the servicers to that go into effect today.

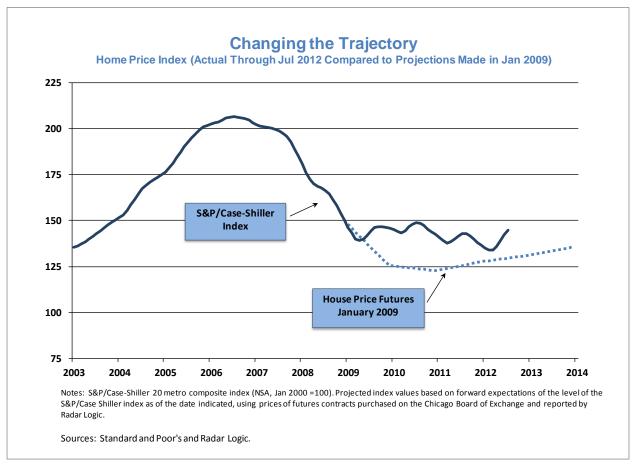
These include fundamental reforms like preventing a bank from foreclosing on a home at the same time that family is awaiting a modification, as well as customer service improvements like an online portal where homeowners can securely upload documents and a single point-of-contact for homeowners seeking help.

These standards build upon the lessons of HAMP as well as the new protections introduced when the President announced the Homeowner Bill of Rights.

Perhaps most important of all, the Consumer Financial Protection Bureau, created by the Dodd-Frank Wall Street Reform Act, is in the process of making these reforms rules of the road that will apply to not just the five banks party to the settlement, but to the entire mortgage servicing industry.

## **Housing and Communities Built to Last**

And so, this morning, I've laid out ways our strategies have evolved and strengthened over the course of the last four years.



While a fuller evaluation will need to be done by economists and historians with greater analysis and the perspective of time--and despite the fact that our progress has not been made in a straight line--it's clear that housing is stronger than most expected at the time the President took office.

Obviously there also remains a lot of work ahead in recovering from this crisis -- and as we continue to rebuild our housing finance system and ensure a crisis like this never happens again.

Which brings me to your discussion today.

The fundamental tension in most of the issues you will be discussing is how to create rules of the road without stifling competition and entrepreneurship -- or impeding access.

To take one example, the current debate about what constitutes a so-called "Qualified Mortgage" and "Qualified Residential Mortgage."

There are some who look at today's market and see that the broader underwriting requirements proposed under QRM would have limited impact on today's lending -- and the conclusion they draw from that is that we need a narrower definition.

But the loans we should be looking to limit aren't the safe loans being made in today's tight market -- but those that were being made in the midst of the bubble.

For instance, less than 15 percent of the loans being made in 2006 would qualify under even the broader definitions we are considering of a QRM.

We need to remember that the goal of this debate is not to limit credit further, but rather to ensure that the kind of access we are encouraging doesn't cause another crisis.

Another debate is the proper role of government -- and particularly the guarantees that it provides in the market.

As we have made clear, this Administration believes that private capital needs to come back -- and that government's footprint in the housing market needs to be much smaller.

This crisis has exposed the fundamental flaws in the model of the GSEs -- from inadequate capital standards to a profit-maximizing structure that undermined their public mission. These criticisms and others were laid out clearly in our White Paper.

But at the same time the crisis has exposed those flaws, it's also demonstrated, as Mark Zandi has as well, that the government can play a key countercyclical role in supporting the market as private capital pulls back.

These are the tensions you will be discussing today -- bringing private capital back and reducing government's footprint while also preserving the fundamental role of credit support and liquidity in what is the second largest securities market in world.

With a clear understanding of recent history--of what has worked, what hasn't worked and whymy hope is that you will help steer these conversations in a constructive direction -- that builds on our progress, that understands we need to harness the vitality, innovation and creativity in our

system in a responsible way, and that ensures the responsible access that was once the hallmark of our housing market and is a cornerstone of the middle class.

It's a tall order -- but based on our progress so far, one I believe we can meet together.

So, thank you for this opportunity -- and enjoy the rest of the discussion.